

AR27

ANNUAL REPORT

FOR YEAR ENDING
31 DECEMBER 1978

PHOENIX CANADA OIL COMPANY

LIMITED

Phoenix Canada Oil Company Limited

Incorporated in Ontario, Canada, 25 November 1944

Directors	S. DONALD MOORE JASON GOULD JOHN A. MURPHY	Toronto, Canada Irvington-on-Hudson, New York Scarborough, Canada
Officers	S. DONALD MOORE JOHN A. MURPHY	President Secretary-Treasurer
Offices	EXECUTIVE OFFICES	700 — 15 Toronto Street Toronto, Canada M5C 2E3
	ECUADOR	302 — Pazmino 245 y 6 de Diciembre Quito, Ecuador
	UNITED STATES (DIRECTOR REPRESENTATIVE)	285 Madison Avenue — 17th Floor New York, New York 10017
Banking	THE ROYAL BANK OF CANADA MAIN BRANCH	Toronto, Canada
	THE BANK OF NOVA SCOTIA NEW YORK AGENCY	New York, New York
	BANK OF AMERICA SUCURSAL QUITO	Quito, Ecuador
Stock Exchange Listing	MONTREAL STOCK EXCHANGE TORONTO STOCK EXCHANGE (Accepted June 1979)	
Transfer Agents	GUARANTY TRUST COMPANY OF CANADA	88 University Avenue Toronto, Canada M5J 1T8
Auditor	GARDNER, McDONALD & CO. CHARTERED ACCOUNTANTS	Toronto, Canada
Capitalization	AUTHORIZED	5,000,000 Shares (\$1.00 par value)
	ISSUED	2,224,101 Shares

The contents of this Shareholder Annual Report is intended to inform present Shareholders about the Company and its operation. It is not an offer of sale or a solicitation of an offer to buy securities unless preceded or accompanied by a current Prospectus which contains information concerning the Company and on any current public offering of its securities.

obtain Parliamentary approval to establish a secure legal basis for long-term operations, will be completed by October. Recent legislation provides interesting incentives and a reasonable tax structure. Our geological rationale for this acquisition involves the correlation of stratigraphy underlying our acreage with that of the Salawati Basin, in Indonesian western New Guinea Island, the locale of recent prolific discoveries now in commercial production. A significant clue to the potential presence of reef build-up underlying our contract area was derived from our palaeontological (fossil) study of unpublished data on two nearby unsuccessful Amoco wildcats. Our comprehensive legal-taxation-geological summary report on this project is now under study by several foreign majors as potential farmees or joint venture partners.

Other Interests

All 6 gas wells in the Clay County, West Virginia lease in which Phoenix holds an approximate 12.5% working interest are now in full production. With the current area gas price, including BTU premium, averaging \$1.64/MCF, a material improvement in project income will be posted in succeeding periods.

We are hopeful that our Phillips-operated Nigeria royalty interest (0.31325% of gross) on the 109,252-acre Gilli Gilli block is nearing a production decision. Nigerian oil price hikes (14.3% in 1977) have outpaced OPEC-sanctioned increases. Current Nigeria 37° API crude price is \$14.63/bbl.

Our improved working capital position has expanded Phoenix participation in Alberta and other Provincial oil lease sales. We are investigating several avenues for the promotion of geologically-attractive Western Canada land plays involving primarily the employment of our capital dollars in lease acquisitions, rather than in rank wildcat drilling, for the time being.

Submitted on Behalf of the Board
by: S. DONALD MOORE, President

31 August 1977

phoenix canada oil company limited

STATEMENT OF OIL PRODUCTION INCOME AND CHANGES IN FINANCIAL POSITION

For the Six Months Ended 30 June 1977
(With comparative figures for the period 30 June 1976)
(Prepared from Company Records without Audit)

	30 June 1977	30 June 1976
Foreign (Ecuador) gross operating revenue from oil production	\$1,232,565	\$2,332,392
Less: Direct operating expenses; — Pipeline tariffs	21,293	40,196
	<u>1,211,272</u>	<u>2,292,196</u>
Less: Foreign (Ecuador) taxation, including income and export taxes, port and pipeline taxes, and foreign exchange charges (Note 2) -		
	1,069,015	2,024,390
	<u>142,257</u>	<u>267,806</u>
Less: Administration and general expenses	36,953	47,702
Depreciation	88	110
Deferred Ecuador expenses written off and amortization of administration expenses	10,377	9,447
	<u>47,418</u>	<u>57,259</u>
Net operating income	94,839	210,547
Net investment income	18,428	11,254
Net income for the period	<u>\$ 113,267</u>	<u>\$ 221,801</u>
Earnings per share	<u>5.6 cents</u>	<u>10.97 cents</u>

CHANGES IN FINANCIAL POSITION

Working capital derived from:	
Net income for the period	\$ 113,267
Non-cash items	10,465
	<u>123,732</u>
Working capital applied to:	
Exploration and development expenses	16,314
Advances to associated companies (Note 1)	2,379
	<u>18,693</u>
Increase in working capital	105,039
Working capital beginning of period	850,363
Working capital at end of period ..	<u>\$ 955,402</u>
	<u>\$ 664,135</u>

NOTE 1 — From June 1974, the Company was required to invest 50% of net Ecuador income, after Ecuador taxes, on approved national development projects. Investments and advances to a major hotel development in Quito were approved in October 1975 and are being made out of these Ecuador funds. Uninvested funds remain on deposit in the Central Bank of Ecuador.

NOTE 2 — At 31 December 1976, excess foreign (Ecuador) business income tax credits applicable on future Ecuador net income, under the Canada Income Tax Act, aggregated \$4,883,321.

interim shareholder report
for the six months ended 30 June 1977

phoenix canada oil company limited

suite 700 • 15 toronto street • toronto • canada • MSC 2E3

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to PHOENIX shareholders:

Financial Notes

In June, retroactive to the 1976 year-end, the Ecuador Government completed the purchase of all Gulf's Ecuador oil interests. Phoenix royalty income was reduced about 50%, to an average 487 bbls/day in the first half 1977 from 920 bbls/day, in the comparable 1976 period. Second half improvement is expected from increased investment income and production from all six West Virginia gas wells now on stream. As discussed below, Ecuador's purchase from Gulf serves the important purpose of providing a finite "handle" on the critical "numbers" we must deal with in the ongoing Texaco-Gulf litigation.

Arctic Islands — Northwest Bathurst Wildcat

We have been notified of the \$3,691,000 budget authorization for a joint Panarctic-PetroCanada wildcat slated to 11,100 feet on the Stokes Range Anticline, located entirely within our 704,273-acre 3.4% carried net profits interest block (a further 1.625% gross royalty is held in 126,564 acres.) Drilling is scheduled for early 1978. The large, closed, Stokes Range structure was first located during our early 1960's photogeological and field geological surveys. The comparable prospective horizons at the nearby Bent Horn discovery area, oil-bearing over a gross section of about 1300 feet of Devonian carbonates, tested clean, light, high quality 43° API oil, with no water. Panarctic has developed plans for an 16-inch pipeline to an anchorage at Freeman's Cove, on southeast Bathurst, where crude could be shipped year-round to Eastern Canada by Arctic Class 7 ice-breaker tankers.

Ecuador Activities

In June, Ecuador paid an initial \$82,128,000, with a final \$35,372,000 subject to independent audit, for Gulf's remaining 37.5% equity interest in Ecuador operations. Gulf has announced they anticipate receiving virtually the entire final installment. Gulf has stopped our royalty payments despite the fact that the Ecuador-Gulf purchase contract provides that Gulf is responsible for all "third party" obligations, which includes the Phoenix-Norsul royalty. Our Texaco-Gulf litigation will now deal with an established "handle" on the most critical "numbers" involved. The relative evaluation of royalty vs.

working interests in the Ecuadorian Oriente jungle then becomes a relatively simple matter of expert testimony based on well-established oilfield practice. Initial Delaware Court argument on certain threshold matters is scheduled for September 12th. It is inappropriate to speculate on the outcome. In comparable New York State Court litigation involving Venezuelan royalty, the plaintiff royalty-owners' position prevailed completely in largely similar threshold questions.

Prospects for an economic service-type contract covering key areas within the former Minas-Yasuni Concession Contract remain pending. Final drafts of both the Hydrocarbons Law revisions and operating contract form are under consideration by Cabinet and is the subject of current local press debate. We consider the more than \$20,000,000 of Amerada Hess, Aminoil et al exploration work in 1967-71, duplicated only at a cost of up to \$70,000,000 at current prices, a significant residual asset in future service contract negotiations. Out of 6 wildcats on Minas lands, 4 were commercial discoveries, flowing 15° to 26° API oil at rates from 200 to 1290 bbls/day.

Northwest Territories Coal Prospect

Only preliminary findings are available on the Summer's field geological survey of our 389,000-acre coal exploration license at Great Bear Lake, about 90 miles east of the aborted Mackenzie pipeline corridor. Isolated outcrops indicate a prospective major, flat-lying, intermittently coal-bearing horizon of from 200 to 300 feet thick, largely amenable to open-pit mining. Individual coal seams up to 30 feet thick are indicated to extend over large areas. Even thicker and more continuous seams appear likely inland from the lake shore. For many miles, the shore line along Deer Pass Bay is continuously strewn with coal fragments, deriving from massive mud slides down the Scented Grass Hills cliffs. Extensive core drilling is necessary to establish coal quality, seam continuity and open cast mining reserves. Unweathered composite samples returned analyses averaging 10,600 BTU/lb, 0.37% sulphur, 45.66% fixed carbon, 6.91% ash and 47.43% volatiles — a prime conversion quality coal.

Several majors are currently assessing the complex economics, now complicated by the unfortunate Berger Report. Why this perhaps well-intentioned study of a highly technical nature, and of crucial national urgency, was entrusted exclusively to laymen, without the benefit of even independent industry counsel, is incomprehensible. Its conclusions were not constructive, but obviously destructive of the economic well-being and "lifestyle" of the vast majority of North American population and industry. With a perceptibly political bias, the Berger Report concluded that the "protection" of the "lifestyle" (translated as poverty-stricken squalor) of a miniscule native population constituted a desirable "cultural" benefit. Basically, we can only read such conclusions as additional pressure, by collectivist philosophers, for more free-loading handouts to non-productive groups, at the expense of the increasingly harassed and declining productive sector of our society. Why cannot native "lifestyle" improvements be fostered by an indispensable multi-billion dollar project that provides meaningful and productive long-term employment?

Alberta Interests

Our 2,560-acre lease block at North Bindloss has been pooled with Dome and Eagle acreage to form a 5,120-acre drilling block. Phoenix holds an undivided 50% working interest. We have developed an attractive subsurface geological picture preparatory to a joint farmout offering. Financing for the initial wildcat earning well, to be drilled at no cost to Phoenix, is expected shortly. New drilling and farmout activity has recently erupted in this formerly dormant area; 2 gas discoveries are reported. Another farmout offering will be made on our 2,560-acre West Rimbey block. The subsurface geology indicates the prospective structure entirely underlies our acreage, thereby reducing ultimate dilution of our working interest.

Papua New Guinea Exploration

In late June, Phoenix was awarded the 4,150,000-acre Petroleum Prospecting License No. 6, located within the Cape Vogel Basin of Northeast Papua New Guinea. The final contract confirming taxation and Government participation provisions, which will

THE DIRECTORS' ANNUAL REPORT

Financial Notes

Net income for the year under review (before extraordinary items) increased 34%, despite modest declines in Ecuador oil production revenues and net income. After extraordinary items, net income (earnings per share adjusted for a 1978 increase in share capital) increased 390%; to \$345,870 (15.55¢ per share) in 1978 — from \$88,440 (\$4.37¢ per share) in 1977. Improved 1979 Ecuador net income should result from sharply higher export oil prices and Government actions to maintain maximum production consistent with reservoir performance.

Nigeria royalty production will commence about mid-June. The initial production rate, barged to coastal export terminals, will be about 4,000 bbls/day. Wellhead prices have not yet been established.

The successful June 1978 Shareholder Rights Offering increased working capital by about \$600,000. The Company is well-positioned to originate and to undertake "ground-floor"

participations in potentially major energy exploration and development projects in North America and elsewhere. The Company has moved into a position where it will originate its own geological plays, and complete the "core" land and lease acquisitions, for subsequent exploration and development by others.

Management is pursuing negotiations on several potentially large foreign projects where the Company has access to proprietary geological and geophysical data. Upon successful completion of a foreign exploration and development agreement, which is expected to conform to the generally employed service contract or production-sharing format, the essential risk financing will follow, based on tentative commitments already arranged.

Ecuador Assets and Operations

The continuing turmoil in world oil markets has caused an explosive rise in Ecuador oil export prices. A complex Government formula, which

currently includes reference to Platt's Oilgram world spot prices, now controls Texaco's Coca Concession royalty payments. For the First Quarter 1979, the January price basis was US\$12.76, February US\$13.53 and March US\$17.98. Subsequent increases were sharper; CEPE, the Ecuador State Oil Company, established the export price basis of US\$26.80 as of June 1. The formula also provides for price declines as and when world crude markets stabilize.

The Company's 1% gross royalty now applies only to Texaco's 37½% equity share in Coca Concession area production, currently deriving from approximately 120 producing wells. Ecuador's gross oil production during the First Quarter 1979 averaged about 220,000 bbls/day, the highest in several years. At this rate, the Company's royalty applies to about 175,000 bbls/day of Coca Concession production.

In May, the independent international audit employed to determine the final payment to

Gulf on their sale to CEPE of their remaining 37½% equity interest in Ecuador operations was completed; of the US\$35.372-million claimed by Gulf, US\$33.4-million was awarded and paid. The purchase price aggregated US\$115.53-million.

The May 1977 purchase and sale agreement between the Government of Ecuador, CEPE and Gulf concerning Gulf's 37½% equity interest expressly establishes (in Clause 2-13) Gulf's sole responsibility for all third-party obligations. Following this sale (in fact, as of January 1977), Gulf terminated royalty payments to Phoenix.

The Company's legal action against Texaco and Gulf has been amended to include the appropriate claims on all cash payments received by the Defendants (US\$115.53-million received by Gulf, as described above — and a further US\$65-million received or receivable by Texaco and Gulf in consideration for their 1974 sale of a joint 25% equity interest) in connection with their sales of equity shares in Ecuador oil

operations which resulted in termination of Phoenix royalty payments to the extent of such sales. The proportion of such cash payments claimed by Phoenix will be established by expert witness testimony assessing the value of the Phoenix royalty interest in relation to the value of the sold Texaco and Gulf working interests (62.5%), in accordance with established industry practice.

This litigation is now moving more rapidly through numerous pre-trial motions and hearings. The crucial document productions and discoveries are substantially complete. The Trial date can be set shortly after the oral examinations, under oath, of certain of the Defendants' senior officials are complete.

After extended reviews and delays, the Ecuador Hydrocarbons Law was revised in November 1978 to enable the relevant Government entities, including the Ministry of Natural Resources and CEPE, to enter into the service contract or production-sharing type of exploration and development agreement with foreign companies. Under its general terms, the operator

recoups capital investment and operating costs, and including profits, by way of a share of oil and gas production developed in the area under contract. Phoenix has delivered certain formal proposals applicable to both a portion of former Minas-Yasuni lands and on another proposed contract area on which certain proprietary geological and geophysical data is available.

Between 1968 and 1972, our Minas-Yasuni contract area working interest partners expended approximately US\$22-million on basic exploration and for six rank wildcat wells. The drilling programme resulted in four commercial discoveries, one marginal discovery and one dry hole. The current "replacement" cost or value of such expenditures has increased by more than 300%. A substantial proportion of critical technical data, primarily seismic records, remain in the possession of the former operator, Amerada Hess. Access to this invaluable information is subject to a tentative agreement with Amerada Hess which Phoenix will attempt to implement if economic service contract terms can be negotiated with the Ecuador Government.

Earlier this year, Texaco and CEPE agreed to the substantial exploration and development expenditures required to expand Eastern Ecuador oil production capability to 350,000 bbls/day. A large proportion of these operations will be conducted on the Coca Concession area subject to the Phoenix royalty.

The Company's international-class 5-star US\$15-million Quito hotel project (La Posada de Quito-HOLAPOCA) has entered into contracts with a major international hotel management chain covering project financing, construction management and hotel operations. Equity financing of up to US\$4.5-million (land cost and preliminary development expenses, in which Phoenix has a 50% interest, will account for approximately US\$1.2-million) and long-term mortgage financing of about US\$10.5-million will be required. It presently appears that both the cash equity requirements and the mortgage financing will be substantially provided by Ecuadorian private business interests, an impressive testimonial to the economic merit of this project.

A recent independent land appraisal, required for both the equity and mortgage financing, reported that property land values have appreciated more than 400% over the 1976 acquisition costs. Of the total 27-acre urban land assembly, approximately 7½ acres will be assigned to HOLAPOCA. The remaining lands, to surround the hotel development, will be subdivided for shopping centre and condominium construction as market conditions dictate.

The casino gambling facilities are being designed as a prominent hotel feature. Planned as the largest such facility in Ecuador, the casino operations will capitalize on the nation's new international business stature which is based on its OPEC oil revenues and on scenic Quito's favoured position in South America's expanding tourist industry. In fact, the hotel chain has stated that this project will be designated their South American "Flagship" property. Expanding international tourism has resulted in many more foreign air carriers serving Quito with frequent flight schedules. The casino facility will be operated separately, under contract with an experienced gambling industry operator.

Ecuador's peaceful transition to constitutional government, following fair and undisputed elections held April 29, has importantly advanced Ecuador's stature in the international business and financial community. The new civilian Administration will be inaugurated August 10, Independence Day. The currency remains strong and stable. Foreign trade, based on oil exports and on the important export cash crops of bananas, coffee and cocoa, remains in favourable balance and external debt is relatively low.

Industrial income taxes are moderate and substantial incentives are provided for export-oriented agro-industrial enterprises. The Company has agreed to a substantial investment in a favourably situated growth industry, 100% export-oriented. Construction products for an energy-related industry are involved. Final action awaits certain routine Government approvals.

The Company has been informed of the possibility that the new Administration may review the discriminatory 86% income taxation levied on our royalty oil

income. The Company is presently unable to assess the probability, which must be considered low, for legislation that would revise these punitive taxation rates. However, expanded Ecuador income from any source will be sheltered from Canadian income taxation to the extent of the Company's current \$6-million excess foreign business income tax credit position.

Canadian Oil and Gas Operations

The Panarctic et al Stokes Range exploratory wildcat on Northwest Bathurst Island was abandoned at 10,957 ft. as a dry hole in September 1978. The Company has not been informed on Panarctic's plans, if any, for further exploration on the Company's holdings. The Company retains a 3.4% carried interest in 704,000 acres, and a further 1.625% gross royalty on an adjoining 126,000 acres on Northwest Bathurst Island. Smaller net profits interests are held on several Permit blocks on Ellef Ringness and Ellesmere Islands.

During the year, the Company acquired working interests in several British Columbia lease

acquisitions in joint ventures with independent operators technically capable of originating new geological plays. The Company now holds varying working interests in 17,455 gross acres — 5,494 net acres — in 12 Alberta and B.C. prospects. Gas discoveries, shut-in awaiting markets, have been completed on two B.C. lease blocks, at Boudreau and Sunrise-Dawson Creek, in farmout deals at no cost to Phoenix.

The Company recently entered into an exclusive long-term joint venture with a competent, experienced geologist that will result in Phoenix originating more in-house geological plays as the basis for a more active and direct lease acquisition programme. Several regional studies, delineating more specific areas of interest, have already been completed. In general, special emphasis is being given geological studies in presently relatively inactive Alberta, Saskatchewan, Northern Montana and North Dakota areas. Several Crown sale postings have already been nominated and freehold lease negotiations will start soon.

Nigeria Royalty

Phillips Petroleum, operators of the 109,252-acre OML Lease 96 royalty block (Company interest 35.7999% of 1% of 7/8; or 0.31325% gross) have advised that commercial production will commence mid-June at about 4,000 bbls/day. Two field discoveries have been reported on this acreage — Gilli Gilli, which tested 2,400 bbls/day of high-grade, low sulphur 50.4° gravity light oil and 6.85 MM cu. ft./day of natural gas at 6,700 ft.; the confirmation well flowed 1,104 bbls/day of 49° and 552 bbls/day of 35.6° gravity sweet light oil — and Gilli Gilli North, which tested 672 bbls/day of 49° gravity sweet light oil at 7,200 ft. Until reservoir performance is established, production will be barged to coastal export terminals. Based on limited technical data, the Company estimates that the existing pools could produce up to 30,000 bbls/day under optimum conditions. Excess capacity is available in the Marathon-Pan Ocean Ogharefe Field pipeline, about 20 miles from the Gilli Gilli pools.

Strong world demand for sweet, light crude has resulted in

Nigeria's output commanding substantial premiums over the OPEC "marker" prices. On the spot market, Nigerian oil has traded for up to US\$40 per barrel; the "official" export price, after the latest OPEC price increase, is US\$23.45 per barrel. Phillips has not informed the Company on the proposed royalty oil pricing basis; however, the underlying 1972 Agreement establishes royalty payments as a direct Phillips obligation, payable as directed by Phoenix.

Other Interests

Phoenix retains an approximate 12.5% working interest in a 6-well gas production

unit in Clay County, West Virginia. Capital investment and net income are modest, but as area gas prices approach US\$2.00/MCF, the project's long life reserves will provide a timely payout and a useful cash flow for many years.

Based on proprietary technical data available to the Company, Management is presently negotiating on several foreign oil and gas exploration and development contracts, outside of Ecuador. As world oil prices continue to rise, the economics of certain potentially restrictive service contract terms improve and chances for a successful agreement increase. A feasible

service or production-sharing contract, substantially in the pattern already established in numerous oil producing or oil prospective nations, can now readily be financed to meet the long-term exploration and development commitments required. Management is concentrating on foreign projects which will operate in more favourable political environments and in areas which provide the geological potential for major hydrocarbon discoveries.

Submitted on behalf of the Board;
by: S. DONALD MOORE,
President

22 June 1979

Consolidated Balance Sheet as at December 31, 1978*(with comparative figures for the previous year)***ASSETS**

	1978	1977
Current		
Cash and deposit receipts	\$1,774,943	\$ 466,967
Marketable securities, at cost (market value 1978 — \$30,183; 1977 — \$31,064)	35,559	35,559
Accounts and deposits receivable	55,495	583,559
	<u>1,865,997</u>	<u>1,086,085</u>
Investments		
Shares, at cost	1,000	1,000
Advances	16,768	22,764
	<u>17,768</u>	<u>23,764</u>
Other, at cost		
Land held for development — Ecuador (Note 3)	212,751	212,751
Land development costs — Ecuador (Note 3)	123,763	—
Interests in petroleum and natural gas permits and/or leases	273,765	119,863
Mining properties	100	100
Furniture and fixtures, less accumulated depreciation	4,392	6,174
	<u>614,771</u>	<u>338,888</u>
Deferred		
Organization expenses, at cost	3,770	3,770
Exploration, development and administration expenses, at cost less amounts written off	281,493	278,701
	<u>285,263</u>	<u>282,471</u>
	<u>\$2,783,799</u>	<u>\$1,731,208</u>

LIABILITIES

Current		
Accounts payable	\$ 100,263	\$ 10,506

SHAREHOLDERS' EQUITY**Capital Stock** (Note 7)

Authorized

\$5,000,000 divided into 5,000,000 shares with a par value of \$1 each

Issued and fully paid

2,224,101 shares

Less: Discount on shares**Add:** Premium on shares**Retained Earnings**

2,021,856 - Fl card. Dec 31/77
 202,185 } note 7
 60
 2,224,101

2,224,101	2,021,856
(1,696,096)	(1,696,096)
414,719	—
<u>942,724</u>	<u>325,760</u>
1,740,812	1,394,942
<u>2,683,536</u>	<u>1,720,702</u>
<u>\$2,783,799</u>	<u>\$1,731,208</u>

Approved by the Board:
 S. DONALD MOORE, Director
 JOHN A. MURPHY, Director

See Notes to Financial Statements

AUDITORS' REPORT

To the Shareholders
 Phoenix Canada Oil Company Limited

We have examined the consolidated balance sheet of Phoenix Canada Oil Company Limited as at December 31, 1978 and the consolidated statements of income and retained earnings, exploration, development and administration expenses and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Ontario
 April 3, 1979

GARDNER McDONALD & CO.
 Chartered Accountants

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS
For the year ended December 31, 1978

	1978	1977
Foreign (Ecuador) gross operating revenues from oil production	\$2,201,714	\$2,521,635
Less: Direct operating expenses: Pipeline tariffs	52,806	44,547
	2,148,908	2,477,088
Less foreign (Ecuador) taxation; including income and export taxes, port, pipeline and foreign exchange taxes	1,852,678	2,187,766
Net oil production income	296,230	289,322
Less:		
Administration and general expenses	117,077	81,479
Oil and gas exploration	5,000	—
Depreciation	1,782	2,520
Deferred Ecuador expenses written off and amortization of administration expenses	20,754	20,754
	144,613	104,753
Net Ecuador operating income	151,617	184,569
Net investment income	93,028	39,949
Other operating income	62,797	—
Foreign exchange gain	38,428	33,141
Income before extraordinary item	345,870	257,659
Extraordinary item:		
Write-off of Manitoba gold properties abandoned	—	169,219
	345,870	88,440
Retained earnings at beginning of the year	1,394,942	1,306,502
Retained earnings at end of the year	\$1,740,812	\$1,394,942
Earnings per share (before extraordinary item)	15.55 cents	12.74 cents
Earnings per share (after extraordinary item)	15.55 cents	4.37 cents

CONSOLIDATED STATEMENT OF EXPLORATION, DEVELOPMENT AND ADMINISTRATION EXPENSES
For the year ended December 31, 1978

	Mining Claims	Oil and Gas Leases	General	Total
Balance at beginning of the year	\$ 1,823	\$230,000	\$46,878	\$278,701
Additions during the year	24,338	5,075	—	29,413
	26,161	235,075	46,878	308,114
Less:				
Amortization	—	11,379	9,375	20,754
Recovery	237	5,630	—	5,867
	237	17,009	9,375	26,621
Balance at end of the year	\$25,924	\$218,066	\$37,503	\$281,493

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
For the year ended December 31, 1978

	1978	1977
Source of funds		
Net income for the year	\$ 345,870	\$ 88,440
Add: Charges not requiring the use of funds		
Depreciation	1,782	2,520
Amortization and write-off of exploration, development and administration expenses	20,754	189,973
Funds from operations	368,406	280,933
Proceeds on sale of shares and warrants	616,964	—
Recovery of advances from associated companies	5,996	—
	991,366	280,933
Application of funds		
Exploration and development expenses (net)	23,546	25,373
Advances to associated companies (net)	—	8,627
Purchase of fixed assets	—	7,812
Interest in oil and gas, permits and/or leases	153,902	13,905
Land developments costs — Ecuador	123,763	—
	301,211	55,717
Increase in funds during the year	690,155	225,216
Funds at beginning of the year	1,075,579	850,363
Funds at end of the year	\$1,765,734	\$1,075,579
Represented by Working Capital		
Current assets	\$1,865,997	\$1,086,085
Current liabilities	100,263	10,506
	\$1,765,734	\$1,075,579

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the year ended December 31, 1978

1. Significant Accounting Policies**a) Basis of Consolidation**

The company accounts for its share of the assets, liabilities, and deferred expenses of the corporate joint venture "Holapoca" in which it participates, by the proportionate consolidation method. The joint venture is in the development stage and the summary of the company's share of the operations is as follows:

	1978	1977
Cash	\$ 1,219	\$177,900
Deposit certificate	54,556	—
Land improvements	115,852	—
Deferred development expenses	15,907	—
	187,534	177,900
Accounts payable	9,634	—
	<u>\$177,900</u>	<u>\$177,900</u>

b) Assets in Ecuador

Assets in Ecuador are included on the company's balance sheet although investment restrictions require that 50% of earnings in Ecuador be reinvested in the country. Consequently, the company has purchased land and has entered into a Corporate Joint Venture to develop a hotel. As at December 31, 1978, there were net current assets of \$629,943 in Ecuador.

c) Translation of Foreign Currencies

Accounts maintained in foreign currencies have been translated into Canadian funds as follows: current assets, and current liabilities at the rate of exchange in effect at the year end and other assets at historical rates. Gains or losses resulting from translation are reflected in the consolidated statement of income.

d) Interests in Oil and Gas Rights

Interests in other oil and gas rights, and mining properties in the amount of \$273,865 can be realized from the future commercial success of these properties or the proceeds from disposition thereof.

e) Deferred expenses

The company has followed the policy of deferring all exploration, development and administration expenses until the commencement of production of the property. As the company is now receiving income from its 1% Production Payment Interest in the Texaco-Gulf Coca Contract of 16th July, 1965, Ecuador exploration and administration costs of \$11,379, together with \$9,375 are being written off annually over a ten year period. As at December 31, 1978, \$124,524 has been written off.

2. Ecuador Interests

Pursuant to Ecuador Ministerial Resolution No. 11927 dated June 30, 1974, the company's production payment income derived from the Texaco-Gulf Contract of 16th July 1965 has been affected as follows (see also Note 6):

- a) Texaco must complete quarterly production payments to the Banco Central des Ecuador within 8 days of the end of each quarter; delays are subject to interest penalties; and
- b) Quarterly production payments shall be based on Reference and Export Prices established from time to time by the Ecuador government; and
- c) The volume of crude oil production on which the company's production payments shall be based is established as gross oil production from the Texaco interest in Coca Concession Contract area, less only such produced crude oil consumed in normal operations or through evaporation and for pipeline losses.

3. Ecuador Investments

Pursuant to Ecuador Ministerial Resolution No. 11927 dated June 3, 1974, the company is required to invest 50% of its net income from the Coca Contract in Ecuador in approved national development projects. The company has invested \$212,751 on the purchase of land together with development costs of \$123,763 located within the national capital of Quito, free and clear of all liens and encumbrances, to be developed as the site of a luxury hotel project. After recovery of all investments and costs out of first proceeds, the company will hold at least a 30% equity interest in the hotel development and operating company. Increased equity interest depends on the performance of certain undertakings by others. An independent professional appraisal has reported that this land value has appreciated, as of early 1978 to about 400% of the company's cost.

4. Payments to Officers and Directors

During 1978 the company paid \$29,500 to officers and directors for services rendered. No remuneration was paid to directors for their services as directors.

5. Foreign Business Income Taxes

Due to the payment of direct Ecuador income taxes under the Ecuador Income Tax Code at the fixed rate of 86%, pursuant to Supreme Decree No. 602 dated May 29, 1973, and published in the Official Register of June 4, 1973, the company has no Canadian income tax payable for 1978. The excess of foreign business income tax has established a foreign business income tax credit under Canada Income Tax Law which at December 31, 1978 aggregated \$6,102,416.

6. Gulf Agreement of Sale of 37.5% Working Interest

Effective as of December 31, 1976, the Ecuador Government completed the purchase of the 37.5% Gulf Oil Corporation working interest in Ecuador oil production rights and operations. On May 31, 1977, Gulf announced that it had received an initial \$82 million payment under a purchase and sale agreement which provides for additional payments of up to \$35 million, following an independent audit by a major international auditing firm. Their report is due by June 1979. Accordingly, the company is currently not receiving production income from Gulf's Ecuador interests and is taking legal steps to secure an equitable proportion of the said considerations based on the relative values of the company's royalty-equivalent interest and the Gulf working interest.

7. Capital Stock

During the year the company issued 202,185 rights to shareholders. These rights entitled the shareholders to purchase 1 share for \$3.00 and 1 warrant at a price of \$.05. All rights were exercised, resulting in the issue of 202,185 shares for \$616,664. The warrants entitle each shareholder to purchase one share at a price of \$5.00 per share prior to June 30, 1980. During the year 60 warrants were exercised, resulting in the issue of 60 shares for \$300.

